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IN THE

United States Court of Appeals

FOR THE THIRD CIRCUIT

No. 12,255

TELESERVICE COMPANY OF WYOMING VALLEY, *Petitioner-Appellant*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF AND APPENDIX FOR PETITIONER-APPELLANT

EDWARD P. MORGAN,
HERBERT E. FORREST,
710 Fourteenth Street, N.W.,
Washington 5, D. C.,
Counsel for Petitioner-Appellant

Of Counsel:
WELCH, MOTT & MORGAN,
710 Fourteenth Street, N.W.
Washington 5, D. C.

July 15, 1957

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Internal Revenue Code of 1954:
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Section 118 (a) 37a
Section 362 (c) 37a

Regulations:

Treasury Regulation 111 (Internal Revenue Code of 1939):

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Income Tax Regulations (Internal Revenue Code of 1954):

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APPENDIX A

Docket Entries

1955

Apr 4—Petition received and filed. Taxpayer notified. Fee paid.
Apr 5—Copy of petition served on General Counsel.
May 23—Answer filed by General Counsel.
May 23—Request for Hearing in Philadelphia filed by General Counsel.
May 27—Notice issued placing proceeding on Philadelphia calendar. Service of answer and request made.

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Mar 27—Hearing set June 18, 1956, Philadelphia, Pa.
Jun 19—Hearing had before Judge Tietjens on the merits. Stipulation of Facts with exhibits 1-A thru 5-E filed. Briefs due 8/20/56; replies 9/19/56.
Jun 25—Transcript of Hearing 6/19/56 filed.
Jul 25—Joint motion to correct transcript, embodying corrections, filed. Granted 7/26/56. Copy served 7/27/56.
Aug 17—Brief filed by petitioner. 9/20/56, served.
Aug 20—Motion to extend time to 9/19/56 to file brief filed by respondent. Granted 8/21/56. Served 8/22/56.
Sep 19—Brief filed by respondent. 9/20/56, served.
Oct 19—Reply brief filed by petitioner. 10/22/56, served.
Oct 19—Reply brief filed by respondent. 10/22/56, served.

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Jan 29—Findings of Fact and opinion filed. Tietjens J. Decision will be entered for respondent. Served 1/29/57.
Jan 29—Decision entered, Norman O. Tietjens, J. Div. 1. Served 1/29/57.
Feb 12—Petition for review by U.S. Court of Appeals, Third Circuit, filed by petitioner.
Feb 13—Proof of service filed.

Stipulation of Facts

* * * * *

5. In order to bring television signals to residents of these cities, petitioner constructed what is familiarly known as a community television antenna system; more specifically as follows: A tower was erected, located on a point sufficiently high to overcome intervening terrain, atop which was mounted a master antenna capable of receiving several different television signals; electronic and amplifying equipment was installed designed to transmit over cables the signals picked up by the master antenna; cables were laid from the master antenna to the cities involved, with a distribution cable and/or wire system ultimately terminating in open-end wires located at the residences of those desiring television service through the system. To this open-end wire or terminal, a subscriber could attach a conventional television set and thereby receive the television signals that had been picked up in the initial instance by the master antenna. Petitioner was the owner of the tower, master antenna, electronic and amplifying equipment, cable, wire, terminal receptacles and all other equipment (with the exception of the utility poles) used in the transmission of the television signals from the antenna to said terminal receptacles.

6. When a potential service area was determined, employees of petitioner first solicited possible subscribers for service prior to undertaking the installation of any facilities for making its service available to the said potential service area. Subscribers were requested to sign an application, copy of which is attached hereto and marked Exhibit 3-C. Construction of facilities for the particular area did not proceed until a sufficient number of applications had been received to indicate to petitioner that the extension would be feasible. Such determination was entirely within the discretion of its officers. Upon acceptance of an area for the extension of service, petitioner entered into

contracts with the subscribers, a form copy of which contracts is attached hereto and marked Exhibit 4-D.

* * * * *

12. During the period February 20, 1951, to January 31, 1953, petitioner took no deductions on its income tax returns for depreciation of the physical facilities of the community antenna television system.

13. The Internal Revenue Service treated the above-referred-to initial payments during the two pertinent fiscal years as gross receipts subject to income tax, and set up a depreciation item in each year with respect to petitioner's physical facilities.

Exhibit 5-E

Exhibit 5-E

TELESERVICE COMPANY OF WYOMING VALLEY

Analysis of System Construction Costs and Customer Contributions Accounts

(Balances shown are cumulative totals)

[• • •]

Year and Month	Total Construction Costs	Customer Contributions
1951		
To October 31, 1951	$ 24,138.49	None
To November 30, 1951	41,143.11	$ 7,783.34
December	56,752.39	12,371.68
1952		
January	62,880.64	27,601.98
February	71,051.26	37,913.76
March	74,165.34	43,898.88
April	81,602.10	45,913.88
May	98,059.51	53,767.88
June	108,224.93	62,291.88
July	112,938.83	71,008.53
August	114,717.40	76,156.03
September	117,286.93	88,606.33
October	121,664.20	96,733.08
November	125,838.64	102,495.07
December	129,452.09	111,612.27
1953		
January	133,501.42	116,146.77
February	131,822.82	118,544.47
March	130,565.98	119,206.47
April	131,267.03	119,816.72
May	131,701.99	120,019.47
June	133,218.37	120,222.22
July	133,723.77	120,714.41
August	134,376.34	121,066.23
September	134,581.43	121,252.73
October	135,132.06	121,602.23
November	136,413.59	121,717.73
December	137,169.16	121,891.73
1954		
January	137,118.00	122,193.48

Excerpts From Testimony and Proceedings

9 Whereupon,

Ralph Katrosh

was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

* * * * * * * * * * *

11 Q. Will you relate for the record and for the court what studies you made with respect to the development of this company, if any? A. Originally, of course Wilkes-Barre being in the screened television area, we had no television sets. In the latter part of 1950, one company had developed this community antenna system and we heard about it—that is, I heard about it through a friend, and made some investigations and found out that it was usable. However, it was necessary in the beginning to first find a signal somewhere on top of the range of mountains that surround Wilkes-Barre and Kingston. We worked for about six months until we found a suitable place. After we found a suitable area where the signal could be intercepted, I then approached Mr. Davis and Mr. Smith and told them such a thing was possible.

12 Q. Will you proceed then to indicate any other studies that you may have made, Mr. Katrosh? Did you investigate any other systems that might be operating? A. We investigated two systems. We investigated the system in Lansford that we saw physically and in operation. We investigated another system in Pottsville. That system was not in operation; it was in the process of being constructed.

Q. Roughly, Mr. Katrosh, at what time in your planning would you say that you definitely determined to go forward with the organization of a company with the view to providing television signals to the residents of Wilkes-Barre and environs? A. As well as I can recollect, January of 1951.

Q. Would you indicate now the planning made by your company with the view to financing the operations proposed? A. That was a difficult thing to decide on because our particular system was unlike those that we had investigated in that we had a dead trunk line run. By that I mean a trunk line of coaxial cables that ran for about five miles before any sizable service could be offered. That was costly, and we were not too sure that it would be a success.

Q. The cable run to which you refer was the run from your tower to the outskirts of the community to be served, I gather. A. Yes, from Wyoming Mountain to the edge of the populated areas on the fringe of the City of Wilkes-Barre.

* * * * * * * * * * *

13 Q. After these conferences, what determinations did you make, Mr. Katrosh—when I say "you," I mean your company—with a view to financing the actual building of the system? A. It was an unknown business and we had no precedent to follow. We could not find any definite information on past experiences. It would be entirely too great a risk for us to undertake that investment on a shortlived basis. At that time the licenses for
14 the U.H.F. stations as yet were not issued. However, there were indications that shortly U.H.F. station licenses would be in issue. We knew that one company in our city, Radio Broadcasting Company, would apply. Therefore, it was a great risk to invest money into this. However, there was a demand and a desire to view television in Wilkes-Barre, and we believed that we could bring it to the public, particularly after we had talked with Mr. Mallon and the contribution idea was presented to us.

Q. Is it correct to say then, and correct me if I am wrong, that as a result of your conferences you determined to proceed with the construction of the system with the idea of contributions from potential subscribers as a means of financing the actual construction of the system? A. Yes.

Q. You might state for the record at this point, Mr. Katrosh, your original position with the corporation. A. I was the general manager.

Q. Were you also a stockholder? A. A shareholder and president.

Q. At the time you proceeded with the view to implementing this plan, what considerations were involved in determining the charges that would be made with respect, first, to the monthly maintenance of the system? A. On the monthly maintenance of the system we had had in-
15 formation from the two companies that we had contacted. If I remember correctly, their charge was $3.75 or $3.50, their service charge. We believed that because we had this long trunk line, dead run, to maintain that it was proper for us to charge four dollars. We did not think it would be possible to get any more than four dollars.

Q. In your planning what was it contemplated that this four dollar monthly charge for the subscriber was designed to cover? A. It was designed to cover the maintenance of the community antenna system.

* * * * * * * * * *

16 Q. Will you explain for the record please the mechanical steps which were taken in the actual construction of the system? That need not be in detail, merely indicate the various steps taken from the very
17 first in the actual construction of the system. A. Yes. The very first, of course, was the tower and the intercepting antennas.

Q. May I inquire, had you received any contributions up to that point? A. No. Of course the main trunk line was down to the first distribution area.

Q. That was a distance of how far? A. That was about five miles. Then we erected services in a very limited area and we stopped our construction there because by that time our construction costs were about what we wanted to risk.

We believed that by stopping there and having a limited area whereby we would receive contributions, we could later on go further with the system, and that is exactly what we did.

Q. Will you explain briefly the various steps thereafter taken before extending the system further? A. Before we extended the system?

Q. Yes. A. We solicited the area to find out how many people were interested in contributing to the aid of construction of this system and also received contributions and made the service connection for them. At each time that a contribution was made, before a service was
18 available to the contributor, there was an in-advance maintenance charge made for the services he was to receive for the next thirty days.

Q. Did you have any criterion or reference point to which you related whether you would or would not extend the system, say down a particular street? A. Beyond that point, yes. Beyond that point we analyzed the mail that came in for people that were interested. We sent additional solicitors to find out if other people would be willing to contribute, determined the cost of the next extension which may supply a potential of four hundred, five hundred customers. We could estimate that cost. We didn't have any signed contracts at this particular time in this new area. We did get the reaction of the people in the area, and if that reaction amounted to at least 50 per cent of the cost of construction then we would go ahead using the money that we had obtained from the contributors previous to that.

Q. What explanation, if any, was given to a potential subscriber with respect to this contribution required? At the time an individual was approached, was this explained to him as to what this was for, the contribution? A. Yes, the contribution in aid of construction for supplying the television programs, and at the same time that it had no bearing on the services; that the service charge was an extra item.

19 Q. In making the contribution to the construction of the system, did the individual thereby become entitled to receive the television signals over the system? A. No.

Q. What was the condition precedent to the actual right to receive the signals? A. The payment in advance of the maintenance charge.

* * * * * * * * * * *

Q. Were the amounts received by way of contributions at any time applied by your company for any of the expenses normally chargeable to operation? A. No, sir.

Q. What income of the company was employed for the operating and maintenance charges involved in the business or cost in connection with the business? A. The only income we had was from the service charge.

20 Q. That is, the monthly charge? A. Monthly charge.

Q. In organizing the company, Mr. Katosh, to what did you and your associates look in the economic sense for the profits of the business? A. As mentioned before, we believed that the investment would be too great to realize a profit, and that is why the contribution idea was accepted. Whatever profit we may gain was to come from the service charges.

* * * * * * * * * * *

22 Q. During the period of your association with the company, Mr. Katosh, did it ever declare a dividend? A. No, sir.

Q. Did any of the stockholders receive any moneys, however denominated, from the corporation apart from you as the general manager? A. No, sir.

Q. Were you devoting your full time to the company? A. I devoted full time after the incorporation of the company.

Q. What was the compensation that you were to receive as the general manager? A. Seventy-five hundred a year.

Testimony of Ralph Katrosh

Q. Were you paid that sum each year during your
23 association with the company? A. No. I was paid a collective amount in January of 1953. It was the first remuneration that I had received since the incorporation of the company.

Q. You were paid in one lump sum then for your services that had accumulated to that date? A. That is correct.

* * * * * * * * * *

26 Q. Why did you find it necessary to reduce your initial residential contribution? A. We were begin-
27 ning to stop future construction. We didn't intend to continue on because of the competition from U.H.F. stations, so it was not necessary to have a building fund that was created by contributions. It was not necessary to have it, so we would probably have to spend fifty, sixty thousand dollars on it to make the next extension. However, we had as yet not received from contributions the cost of construction.

Q. This reduction in rate first occurred, I believe you testified, in January of 1953? A. January 1, 1953.

Q. At what time did the U.H.F. stations start to operate in the Wilkes-Barre area? A. I think the first one came on January 1952.

Q. Isn't it true that this reduction in the initial station in a residential area was conditioned on the increased competition used by these U.H.F. stations? A. No, sir.

Q. From the competitive standpoint, you were forced to reduce your contribution? A. We always considered that initial contribution depending on our construction. We had decided not to construct any more. As I said before, our cost of construction had not been reduced at that time.

* * * * * * * * * *

36 Q. Mr. Katrosh, I believe that you mentioned that before going into an area you would make a survey to determine the potential subscribers in that area. A. Yes.

Q. What percentage of it did you say you would require before the extension was made? A. We didn't base it on percentage of residents in the area, we based it on recouping at least 50 per cent of the cost.

37 Q. Suppose that you went into an area on the theory that you could recoup 50 per cent of the cost, you had enough subscribers and additional subscribers wanted to come into your system. What happened then? A. Naturally, we expected additional subscribers in all areas at all times.

Q. Suppose that on the theory that you were to recover 50 per cent of your cost initially and had enough to come on to make up more than 50 per cent of the remaining cost, what would happen then? A. Of course that would depend. We didn't pin it down to areas. After all, this community antenna system was as a whole and our consideration was as a whole and construction as a whole. Naturally the contributions were considered as a whole, too; they were not considered as areas. So our accounting system integrated.

Q. Suppose you had underestimated the necessary number of connections in the area. Isn't it true that in that case you would have had more money received than your actual construction cost? A. You mean for that particular area?

Q. Yes. A. We didn't base it on that. I can't tell you whether we did or not because we based it on the community antenna system as a whole.

* * * * * * * * * *

39 By Mr. Peil:

Q. What provisior did you make, if any, to assure yourself or assure the corporation that your construction costs would never go below the contributions? A. As mentioned before, reduction in the contribution. At the present time it is reduced to zero by the new company—by the new owners, it is the same company.

The Court: In other words, when you got your construction costs recouped, you intended to cut out your initial charge?

The Witness: The contributions would be entirely as they are now.

Mr. Peil: No further questions.

The Court: Suppose your company was liquidated, what would happen? Who would get the benefit, the stockholders?

The Witness: There would not be any benefit, Your Honor, because the salvage value of the equipment would be less than the cost to dismantle.

46 The Court: The only way then you get anything out of this capital contribution, as you call it, is to keep in operation?

The Witness: Keep it in operation and try to operate it: profit from the service charge.

* * * * * * * * * *

41 Whereupon,

George F. Gardner

was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

* * * * * * * * * *

47 By Mr. Peil:

Q. Do you agree that the salvage value from those fixed assets is relatively inconsequential? A. Yes, that has always been taken as a matter of fact. I don't believe I have ever actually sat down and tried to figure it out, but the cost of removing the equipment from the facilities at the utility companies would be substantial and the salvage value is problematical. I would not say that salvage value would go over the cost of removing it.

Q. Then is it true that the motivation for your purchasing this stock was based on the potential in terms of monthly

service income which the corporation earned? A. I certainly believe that would be correct.

Q. If there is no salvage value, that is the only basis on which you could make any money, is that correct? A. Very probable.

* * * * * * * * * * *

48 Whereupon,

Edward J. Mallon

was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

* * * * * * * * * * *

50 Q. Did you offer any suggestions or counsel with respect to possible means of financing the company in contemplation of those problems? A. After some considerable study on the subject we advised them that with the available funds they had themselves they could not actually build or conceive what they were to complete their actual construction because the available capital that they had themselves was not enough to complete a $250,000 project. At that time it was decided that other funds would be needed to complete their task. After research as to how other companies had been financed, it was determined that other operations could be financed using customers' contributions in addition to the contributions by the investors.

Q. Is it correct to say, and correct me if I am wrong, that the decision to follow the route whereby the system would be financed essentially through contributions from respective customers or subscribers was conceived at the very outset of the company's organization? A. Yes. As a matter of fact, it was conceived before any construction was begun and before any moneys were paid into the company by either the investors or the customers themselves, and the attorneys drew the contracts in that form.

Q. Have you handled the accounting work for this company from the beginning down to the present time? A.

From the beginning down to the present time, yes.

51 Q. Did you aid in the preparation of the tax returns for the various years filed by the company? A. Yes, we did.

Q. Upon what theory did you prepare the returns, Mr. Mallon? I am thinking now with respect to contributions particularly. A. The returns were prepared following the accepted cases in contribution.

Q. Did you say accepted cases in the contributions in aid of construction, that line being the prescribed method of accounting that is followed?

The Court: Accepted cases, what are you talking about?

The Witness: The Detroit Edison case and a number of others which are cited in the original petitions.

By Mr. Morgan:

Q. Did the company claim upon its return depreciation upon any of this equipment? A. No. The accounting depreciation was shown, and it was taken as a non-deductible item on Schedule M.

Q. In view of your knowledge and familiarity with the books and records of this company I should like to ask you if based upon those records any of the sums received by way of contributions have been applied by the company toward interest, dividends, or anything else properly payable from earnings? A. On the books of the company

52 the accounting shows a separation of the sums received from contributions as against the sums received from the monthly maintenance charges. The actual funds, as has been testified to by Mr. Katrosh, were deposited in the bank account. They had one bank account, but the funds were segregated on the books of the company so that at all times the total amount received as contributions was obtainable and would be shown on the ledger as distinguished from any other funds received by the company.

Q. Is it correct, as Mr. Katrosh testified, based upon your knowledge of the books, that the total of the contributions never at any time equalled the actual cost of construction? A. That is correct. The accumulative amount received never equalled the accumulative amount spent.

Q. You have testified, I believe, that all contributions received were identifiably recorded upon the books and records of the company? A. Yes, they were.

* * * * * * * * * * *

53 Q. Mr. Mallon, you mentioned that the organizers of the Petitioner came to your firm and discussed with you the way that this corporation should be set up financially and also went over with you the estimated construction costs. Can you tell us how the original installment contribution of $145 for residential property and $200 for commercial property was arrived at? A. As near as I can state on that, it was determined that the construction costs would amount to about $250,000 if they covered the area which they had anticipated covering. The amounts of $145 and $200 were determined entirely on the basis that they knew the amount that was asked by other companies was approximately the same. They felt that if they acquired that amount of money from the number of prospective subscribers that they anticipated, they felt it would just about balance their construction cost. Now that is entirely speculative because you have too much speculation. First you are speculating on
54 cost and you are speculating on the number of subscribers you are going to get, so that the answer has to be in the speculative field.

Q. To the extent that you used other companies who were in the similar field, and you mention of course your estimate was of necessity speculative, did you take into account the potential of the areas which they were serving as against the potential of the Wilkes-Barre area? A. Yes, because I believe their estimates showed the larger the com-

pany, the larger the constructive costs; so that since the contribution was based on the constructive cost proportionately regardless of how large the company is, you are going to get the same answer. You divide the total cost by the total number of customers. The higher company has a higher cost on a higher number of customers, so it would relatively come out to the same figure.

Q. Isn't it true that you have certain basic costs, one being the antenna system, which would decrease? A. No. I am not an engineer, but as I understand the operation the only basic cost which does not increase as you increase the size of the system is the tower itself. Outside of that, every other cost is relative to the number of customers.

Q. In other words, you would agree with my statement?

A. I would say there has to be a proportion between
55 the cost and the number of customers you are going to serve, and it has to be directly proportionate to the number of customers.

The Court: is the cost of the antenna itself relatively large?

The Witness: No. The cost of the antenna itself usually runs from $1,500 to $3,000.

The Court: So it is a small item?

The Witness: Unless you have to purchase land to erect the tower on. Otherwise, it is a small item.

The Court: It still balances out ninety-six cents a foot?

The Witness: Ninety-six cents a foot. It all depends how big an area you are going to cover, and divide by the number of people in that area.

By Mr. Peil:

Q. In taking into account the charges that were made by other companies that were available to you in setting this rate, do you know whether those companies were making a profit on it? Were they recovering their costs based on these figures? A. I don't know the answer to that.

but I would say at that time the figures were probably so new it would have meant nothing anyhow because to my knowledge this company was only the third company in existence.

Q. You didn't specifically inquire into that as a basis? A. Yes, that is right.

56 Q. You say you did not? A. No. We were in contact with the other operators as to what they were charging purely as a guide as to what somebody else charges to see if our figures are far away from what somebody else's estimates were. That was purely the basis of it.

Mr. Peil: No further questions.

Redirect Examination

By Mr. Morgan:

Q. Mr. Mallon, pursuant to one of Mr. Peil's questions reference was made to the payment of some interest by the company on borrowed money. Was it the purport of your testimony that that interest was paid out of the contributions, from the contributions? A. No. That interest was paid out of the monthly maintenance charge. The amount of interest is relatively small because it is stipulated that the loans were anywheres from fifteen to thirty thousand dollars.

Mr. Peil: That interest was, however, paid out of the general account of the corporation?

The Witness: All checks were paid out of the general account of the corporation.

* * * * * * * * * *

Findings of Fact and Opinion

27 T. C. No. 84

Docket No. 57236. Filed January 29, 1957.

The taxpayer corporation promoted, constructed and now operates a community television antenna system in Wilkes-

Barre and Kingston, Pennsylvania. To help finance construction of the system, contributions were solicited from prospective customers. A contribution was a prerequisite to use of the system. It alone however, did not entitle the contributor to receive television signals. The contributor also had to make monthly payments, in advance, in order to receive the signals. A contributor could not sell, assign, or transfer his eligibility to receive television signals, but he remained eligible to receive the signals without additional cost if he moved to another part of Wilkes-Barre or Kingston. However, the person who moved into the contributor's old home was required to make a contribution in order to become eligible to use the system. The petitioner did not claim deductions upon its income tax returns for depreciation of the physical facilities of the system constructed from the funds contributed, but showed the accounting depreciation as a nondeductible item. *Held:* The contributions were not gifts to petitioner or contributions to its capital, but were part payment for services rendered or to be rendered and therefore includable in gross income under section 22(a), I.R.C., 1939.

TIETJENS, *Judge:* The Commissioner determined the following deficiencies in the petitioner's income taxes:

Year Ended	*Deficiency*
1-31-52	$ 3,210.83
1-31-53	13,013.09

Certain adjustments made by the Commissioner were not contested. The only issue presented in this case is whether "contributions" by subscribers to the petitioner's community antenna television system constitute gross income within the meaning of section 22(a) of the Internal Revenue Code of 1939.

FINDINGS OF FACT.

Some of the facts are stipulated. Those facts and the stipulated exhibits are found as stipulated and are incorporated herein by this reference.

The petitioner is a corporation whose address is 153 South Main Street, Wilkes-Barre, Pennsylvania. It was incorporated under the laws of the Commonwealth of Pennsylvania, in 1951. The petitioner filed its returns for the taxable years ended January 31, 1952 and 1953 with the district director of internal revenue at Scranton, Pennsylvania.

The petitioner promoted, constructed, and now operates for profit a community antenna television system at Wilkes-Barre and Kingston, Pennsylvania.

The residents of Wilkes-Barre and Kingston were unable by conventional television roof-top or built-in antennas to receive television signals of an adequate visual quality due to the fact that the cities were located in valleys surrounded by hills which effectively screened or cut off television signals which would otherwise be available for reception by conventional methods. Therefore in January 1951, the petitioner's incorporators determined that a company should be organized for the purpose of providing television signals to the residents of the Wilkes-Barre area through a community television system.

In 1951 no licenses for Ultra High Frequency (U.H.F.) television stations had then been issued, but there were indications that such licenses would be granted in the near future, and it was known that at least one company in Wilkes-Barre would make application for such license. This created a hazard of investing money in the enterprise.

The Radio Corporation of America (R.C.A.) provided engineers to make a survey of the projected system, and furnished estimates of the cost of the equipment and

materials that would be required. Two other community antenna systems were also investigated and on the basis of their experience and the advice received from R.C.A., it was estimated that it would cost 96 cents per foot for the trunk line cable or feeder line cable to be installed and erected. This cost tended to be constant, regardless of the size of the system, since the only fixed cost was that of constructing the antenna tower which was relatively small ($1,500 to $3,000). It was calculated that the cost of constructing a system to serve Wilkes-Barre and Kingston would be as much as $250,000.

The incorporaters held conferences with a certified public accountant with respect to the method of financing the company, including among other things, the cost of operation, availability of capital and money that could be borrowed. Before construction was begun or money paid into the company, it was decided that construction of the system would have to be financed essentially through contributions from prospective customers or subscribers.

Contributors were divided into two classes, residential and commercial. Contributions of $145 were solicited from the former and $200 from the latter. While installation costs were the same the incorporators believed that the commercial establishments could better afford to contribute a greater amount than could a private family. The amount of the original contributions was based upon construction costs and amounts solicited by other community antenna systems.

The charge for monthly maintenance of the system was set at $4 per month for residential subscribers and $6 per month for commercial subscribers. This charge was designed to cover the maintenance of the community antenna system and it included an element of profit. The rates were not set by any regulatory commission.

Findings of Fact and Opinion

The community antenna system was constructed in several distinct stages. The first step was the erection of a tower and intercepting antennas and the installation of a main trunk line cable, approximately five miles in length, to the first distribution area. Cost of the first step was borne by the incorporators. Before further extension of the system potential subscribers were solicited for service. When a sufficient number of applications had been received to indicate that the extension would be feasible the petitioner entered into contracts with the subscribers and then construction proceeded in the area in which the subscribers were located. Six months elapsed after completion of the initial construction before the first extension of the system was undertaken, 45 days before the second extension, and about 60 days before the third extension. It was estimated that at least 50 per cent of the cost of construction of the extensions would be borne by the contributions of the subscribers.

The contract which the subscribers signed provided as follows:

> Telso [petitioner] agrees to furnish Subscriber at the place of installation as noted above a television signal transmission service. Subscriber agrees, in consideration of contributions from other Subscribers, to contribute the sum of ..... Dollars toward the total cost of constructing a system for the transmission of a television signal. Subscriber agrees to pay Telso a monthly maintenance charge of ..... Dollars. The rights and obligations of the parties to this contract shall be subject to and governed by the statements made by Subscriber on the application and by the terms and conditions on the reverse side of this contract, entitled "General Provisions", number one through .....

Findings of Fact and Opinion

GENERAL PROVISIONS

* * * * * * * * *

Section 12—Termination of Service

(a) Termination—Public Utility Contracts—Government Permission

The service furnished by Telso under this contract is under and subject to the conditions of contracts entered into by Telso with various Railroads and Public Utilities and to the terms and conditions of resolutions of the cities, boroughs and townships in which the service is rendered, and to the terms and conditions of permits and licenses granted by various governmental agencies both state and federal. Insofar as they are relevant, the provisions of these contracts, municipal resolutions and governmental permits are by reference made a part of this contract. It is distinctly understood and agreed by Subscriber that the ability of Telso to continue service depends on the continuance in operation of the aforesaid contracts with the utilities, and with the continued authority granted by the various cognizant municipalities and governmental agencies. If for any reason, whether or not due to the neglect or fault of Telso, said public utility and railroad contracts or municipal resolutions or governmental permits as they now exist, or as they are subsequently amended, are cancelled, amended, abrogated, terminated or otherwise changed so as to make it, in the sole judgment of Telso, either impossible or impractical for Telso to furnish television transmission service under this contract, Telso shall have the right to terminate this contract. In the event of termination under this section, all contributions, maintenance rates, and other moneys paid Telso by Subscriber shall be forfeited. Subscriber shall not be entitled a refund of any kind.

(b) Termination—Default by Subscriber

Telso may terminate this contract by written notice to Subscriber whenever Subscriber violates a provision of this contract and the right to terminate for default is given to Telso. Whether Subscriber has violated the contract shall be a matter for the sole

determination of Telso. If Telso terminates this contract under the provisions of this section, Subscriber shall not be entitled to a refund of any kind, and Telso shall in no wise incur any liability.

(c) Termination—For Convenience of Subscriber or Telso

Subject to the provisions of Sections (a) and (b), and subject to the failure of service as provided in Section 1 (c) and (d), either the Subscriber or Telso may terminate this contract on thirty (30) days written notice to the other. A termination notice addressed to the Subscriber at the address appearing on this contract, with postage prepaid, shall be compliance with notice under this Section.

(1) If Telso terminates this contract under this section, Subscriber shall be refunded a part of his contribution money, as follows:

i. A maximum of Sixty (60) Dollars less Ten (10) Dollars for each month this contract has been in effect.

ii. There shall be no refund of any other charge.

(2) If Subscriber terminates this contract under this section, Subscriber shall not be entitled to a refund of any kind.

* * * * * * * * *

Section 17—Assignment

Neither this contract nor any interest herein nor any claim arising hereunder shall be assigned by the Subscriber.

While a contribution was a prerequisite to use of the system, it alone did not entitle the contributor to receive television signals. The contributor also had to make monthly payments, in advance, in order to receive the signals.

A contributor could not sell, assign, or transfer his eligibility to receive television signals, but he remained eligible to receive the signals without additional cost if

he moved to another part of Wilkes-Barre or Kingston. However, the person who moved into the contributor's old home was required to make a contribution in order to become elibible to use the system.

No change was ever made in the $4 monthly charge for maintenance in the case of a residence, or in the $6 monthly charge in the case of a commercial establishment. Also the $200 contribution required of commercial establishments was never changed. However, the amount required of residential subscribers was reduced to $89 on January 1, 1953, to $80 on June 1, 1954, to $30 in August 1955, and no contributions have been required since the beginning of 1956.

The greatest number of connections in operation at one time was about 900 and the least was about 200 to 300. In 1956 there were about 400 connections in operation. The decrease in connections resulted in 1952 when U.H.F. licenses were granted to local television stations in Wilkes-Barre and Scranton. The number of contributions also fell off sharply at that time.

During the period February 20, 1951 to January 31, 1952, the petitioner received under contracts initial payments, other than payments for monthly maintenance, totalling $27,601.98; during the same period construction costs of the system totalled $62,880.64.

During the period February 1, 1952 to January 31, 1953, the petitioner received under contracts initial payments, other than payments for monthly maintenance, totalling $88,544.79; during this same period construction costs of the system totalled $70,620.78.

The television antenna systems equipment had no salvage value.

All initial payments received by the petitioner were credited to an account maintained in its books and records called "Customer Contributions." Segregation of the funds paid as contributions was maintained on the books of accounts of the petitioner, as against sums received

from monthly maintenance charges. The funds were deposited in the petitioner's general bank account from which were paid general operating expenses and the cost of all assets acquired. However the petitioner's accounting system segregated the costs of construction and the amounts contributed. At no time has the total amount of contributions ever equalled the capital outlay required to construct the system.

The petitioner did not claim deductions upon its income tax returns for depreciation of the physical facilities of the community antenna television system but showed the accounting depreciation as a nondeductible item.

Ultimate Finding

The "contributions" to the petitioner were not gifts or contributions to capital; they were part of the payment for services rendered or to be rendered by the petitioner and are includable in petitioner's gross income.

Opinion

The Commissioner included the above referred to "contributions" in the petitioner's gross income during the taxable years and determined a deficiency accordingly. In such determination he allowed the petitioner a deduction for depreciation of the physical assets of the community antenna television system. The propriety of the Commissioner's determination is the issue involved in this case.

The petitioner takes the position that the contributions were contributions in aid of construction and thus not subject to taxation as income. It relies upon the following alleged characteristics of the contributions to show that they were in aid of construction: (1) the parties intended that the contributions be devoted to construction of the capital facility; (2) the contributions were so denominated by contract; (3) the amount of the contribution was reduced from time to time so as not to exceed the costs of

construction; (4) the contributions were treated in tax returns and on the books as contributions in aid of construction; (5) the contributions never exceeded construction costs and never were intended to provide and did not provide a source for payment of dividends, interest, etc., the monthly maintenance charge being, as intended, the only source of profit; (6) the capital facilities were without salvage value, thus obviating any possibility of gain to the petitioner from the contributions; and (7) the contributions were never made nor received for services rendered or to be rendered and they conferred no direct benefit upon the contributor, since he was required to make monthly payments as a condition precedent to receiving monthly service from the antenna system. As authority for its position that contributions in aid of construction are not taxable as income, the petitioner cites: *Edwards* v. *Cuba Railroad*, 268 U.S. 628 (1925); *Liberty Light & Power Co.*, 4 B.T.A. 155 (1926); *Great Northern Railway Co.*, 8 B.T.A. 225 (1927), aff'd. 40 F.2d 372, certiorari denied 282 U.S. 855; *Texas & Pacific Railway Co.*, 9 B.T.A. 365 (1927); *Rio Electric Co.*, 9 B.T.A. 1332 (1928); *Wisconsin Hydro-Electric Co.*, 10 B.T.A. 933 (1928); *El Paso Electric Railway Co.*, 10 B.T.A. 79 (1928); *Tampa Electric Co.*, 12 B.T.A. 1002 (1928); *Midland Valley Railroad Co.*, 19 B.T.A. 423 (1930); *Union Pacific Railroad Co.*, 26 B.T.A. 1126 (1932); and *Texas & Pacific Ry. Co.* v. *United States*, 52 F. 2d 1040 (Ct. Cl. 1931), aff'd without discussion of this point 286 U.S. 285 (1932).

In *Edwards* v. *Cuba Railroad*, *supra*, the taxpayer received certain properties and money subsidies from the Republic of Cuba in connection with the construction of a railroad line. The taxpayer built the railroad itself and owned it, but the Cuban Government paid it a certain amount per mile as the work progressed pursuant to an offer which was designed to induce some one to build a railroad. The Supreme Court held that the subsidy payments did not constitute income within the meaning of the

Sixteenth Amendment since they were not made for services rendered or to be rendered and were not profits or gains from the use or operation of the railroad, but were made to reimburse the taxpayer for capital expenditures. In *Liberty Light & Power Co., supra*, individuals desiring to obtain electric service constructed transmission lines and transferred them to the taxpayer who was required by law to maintain them and furnish service to the individuals. The Board of Tax Appeals (now the Tax Court) held that the transmission lines did not constitute income to the taxpayer under the rule of the *Cuba Railroad* case. It said that the transmission lines were contributed by the individuals to the capital of the taxpayer and were not payment for services rendered or to be rendered. In *Great Northern Railway Co., supra*, it was the practice of the taxpayer, where an industry located along its tracks desired transportation facilities from its plant, to construct the necessary spur track, take title to so much thereof as lay on its right-of-way, and require the industry to pay the cost of construction. The Board of Tax Appeals held that such payments were contributions in aid of construction and did not constitute income, under the rule of the *Liberty Light* case. The other cases cited by the petitioner, *supra*, involve factual situations which are substantially identical to those involved in the *Liberty Light* and *Great Northern Railway* cases, and the rule of those cases was held controlling.

The Commissioner contends that the contributions are includable in the petitioner's gross income under section 22(a) of the Internal Revenue Code of 1939. His position is that section 22(a) taxes all gains constitutionally taxable except those specifically exempted, and he cites as authority, *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955) and *Gen. Investors Co.* v. *Commissioner*, 348 U.S. 434 (1955). He contends that such contributions are constitutionally taxable and that they are not specifically

exempted from taxation since they are neither gifts nor contributions to capital.

We agree with the Commissioner.

During the taxable years, only those persons who made contributions to the petitioner's community television antenna system were eligible to use such system upon further payment of monthly charges. Those who did not make contributions could not use the system. A contributor could not sell, assign, or transfer his eligibility to receive television signals, although once having contributed he remained eligible to receive the signals even though he moved to a different part of Wilkes-Barre or Kingston. However the person who moved into the original contributor's old home was required to make a contribution of his own in order to become eligible to use the system. It should be noted that under certain circumstances part of a contribution was refundable, but we are not concerned with these provisions, since the controversy here relates only to payments which by the contracts have ceased to be refundable. We see nothing in the contracts between the petitioner and subscribers that bound the petitioner to use the "contributions" for any particular purpose.

In view of these characteristics we have made an ultimate finding that the contributions are not gifts or contributions to the petitioner's capital, but are part of the price of services rendered or to be rendered. We think that this finding is inevitable in spite of the voluminous authority cited by the petitioner to support its position that the contributions are in aid of capital construction and thus are not taxable income.

In *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98 (1943), the taxpayer was engaged in the generation of electricity and its distribution to the public. The taxpayer received applications for service, which, in its opinion, required an investment in extension of its facilities greater than prospective revenues therefrom warranted. In such cases it would render the services if the applicant would

pay the estimated cost of the necessary construction. The taxpayer would construct the facilities which then became its property and add the full cost to its appropriate property accounts without deduction for the customer payment. It claimed as a base for depreciation the investment for which it was reimbursed. In holding that it was improper for the taxpayer to include the amount of the customer contributions in its basis for depreciation, the Court said:

> The Company, however, seeks to avoid this result by the contention that what it has obtained are gifts to it or contributions to its capital of the property paid for by the customer, and that therefore * * * it takes the basis of the donor or transferor. It is enough to say that *it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company. The trasaction neither in form nor in substance bore such a semblance.*
>
> *The payments were to the customer the price of the service.* * * * [Emphasis supplied]

We are unable, in substance, to distinguish between the facts of the *Detroit Edison* case and the case at bar. Nor are we able, in substance, to distinguish factually between the *Detroit Edison* case and every one of the cases cited above by the petitioner except *Edwards* v. *Cuba Railroad*. In spite of the sheer weight in number of those decisions, we feel bound to make an ultimate finding consistent with that of the *Detroit Edison* case, and what in our view appears to be a gradually but persistently broadening concept of taxable income as exemplified by the *Glenshaw Glass Co.* and *Gen. Investors Co.* cases, *supra*. As for the *Cuba Railroad* case, which the petitioner so strongly relies upon, we think that case is clearly distinguishable from the present one due to the character and motive of the contributor involved therein. There, the Republic of Cuba was the contributor. Its motive in making the con-

tributions was governmental and altruistic; the sovereign had the public interest in mind when it offered the subsidies to induce the construction of a railroad. The subsidies were not given to obtain concessions in respect of rates for government transportation. Here we have an entirely different situation. Paraphrasing the dissent in *Liberty Light & Power Co., supra*, there was nothing altruistic in the motive which prompted the petitioner's prospective customers to finance the television antenna system; they wanted television service and they were willing to pay for it. If the system had already been constructed and available they would have paid a larger monthly charge and this unquestionably would have been within the petitioner's gross income. Since the facilities were not available and due to the risk involved, the only way that the petitioner could be induced to give service was by the receipt of something in addition to the monthly charge, namely, contributions to enable it to construct extensions of the antenna system. Contributions received in this manner are within the gross income of the petitioner.

We think that the Supreme Court, in deciding the *Cuba Railroad* case, did not intend that the theory of that case should be extended so as to free from taxation a private contribution made in consideration of the performance of the contributee's normal business function. We have support for this view from the *Detroit Edison* case, where the Supreme Court said:

> [The contributions] have not been taxed as income, presumably because it has been thought to be precluded by this Court's decisions in *Edwards* v. *Cuba R. Co.*, * * * holding that under the circumstances of that case a government subsidy to induce railroad construction was not income.

We hold that the contributions in this case are not gifts or contributions to the petitioner's capital, but are the price of services rendered or to be rendered and accord-

ingly they are includable in the petitioner's gross income under section 22(a).

Reviewed by the Court.

Decision will be entered for the respondent.

OPPER, J., concurring: In *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, depreciation deductions were denied on the ground that the taxpayer had no basis. The circumstances under which it had acquired the property seem to me indistinguishable from those present here. There, as here, the taxpayer had no cost. It was assumed that the only way a basis could be achieved was by treating the acquisition as a gift thereby conferring the basis of the transferor. This theory the Supreme Court refused to adopt.

Speaking of the treatment of the acquisitions from the standpoint of taxable income, all that is clear is that they had not been taxed or reported, presumably on the authority of *Edwards* v. *Cuba R. Co.*, 268 U.S. 628. *Detroit Edison* takes no position as to the correctness of that treatment and I agree with the present opinion that we are free to decide here that the value of the contributions constituted income taxable to petitioner in that it was not a gift, *Detroit Edison Co.* v. *Commissioner*, *supra*, nor a contribution to capital. Cf. *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583.

But under the *Detroit Edison* dictum there are only two possibilities. The first is that the contributions never were taxable income and in that event, of course, the present result would be incorrect. The second possibility is that although they should have been reported as taxable income they failed to attain a basis for depreciation because they had never been taken up in the taxpayer's income. Theoretically, where, as in *Detroit Edison* and here, only cost can furnish a basis, the basis would be zero where there is no actual cost. *Helvering* v. *Gowran*, 302 U.S. 238. But where the subject matter has been taken up in income, courts thought it equitable to attribute a basis to that ex-

tent. *Maurice P. O'Meara*, 8 T.C. 622; see *Artis C. Bryan*, 16 T.C. 972; *Johnson* v. *Commissioner*, (C.A. 5) 162 F. 2d 844.[1]

The difficulty with the second hypothesis is that less than 3 months after the *Detroit Edison* opinion was handed down, the Second Circuit held that a taxpayer could take a deduction for a loss on property which should have been but never was reported for tax purposes, even though there was no cost or other statutory basis. *Bennet* v. *Helvering*, (C.A. 2) 137 F. 2d 537. This result was reached without any reference to *Ruth B. Rains*, 38 B.T.A. 1189, upon which the opinion below had been grounded. The *Rains* case was itself merely the culmination of a long line of similar results.[2]

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[1] On the other hand it is said that if she had returned the gain in 1929 and paid taxes on it, the fair value thus capitalized into the property would have been recognized as a proper basis in fixing the gain on the sale in 1938.

* * * * * * *

Since the value was not then or since taken into the tax account as a capital investment, there is no occasion to add it to the basis of the property when sold to avoid taxing it a second time. Justice has been done. * * * [*Johnson* v. *Commissioner*, *supra* at 846.]

[2] The cases last above cited [*Pearl A. Long*, 35 B.T.A. 479; affd., 96 Fed. (2d) 270; *George N. Crouse*, 26 B.T.A. 477; *Searles Real Estate Trust*, 25 B.T.A. 1115; *Henry V. Poor*, 11 B.T.A. 781; affd., 30 Fed. (2d) 1019; *Bothwell* v. *Commissioner*, 77 Fed. (2d) 35; *Larkin* v. *United States*, 78 Fed. (2d) 951] are predicated upon the general principle that a taxpayer can not take as a deduction the loss of a gain which has not been reflected in income. For example, in the *Poor* case, *supra*, the taxpayer deducted from gross income as a bad debt the full amount of a judgment embracing $484.21 interest which had at no time been included in his reported income. The Board applied the principle stated, notwithstanding the taxpayer kept his books on a cash receipts and disbursements basis, and the uncollected interest, therefore, was properly excluded from his gross income.

In the instant case, petitioner is not seeking to deduct directly from gross income the amount of the uncollected royalties, and if such a deduction were claimed, it would not be allowable under the doctrine referred to. However, petitioner is attempting to attain the same result by including the amount of the royalties in the basis to be deducted in computing gain or loss * * *

Substantially the same principle has been applied and the same results obtained in analogous situations based upon slightly different reasoning. In *William Merriam Crane*, 27 B.T.A. 360; affd., 68 Fed. (2d) 649, the petitioner owned certain realty which had been leased to an insurance company. The lessee made improvements of substantial value in 1920 which were to revert to the lessor upon termination of the lease. Petitioner sold the property in 1927, and contended that in computing gain or loss on the sale he was entitled to deduct the depreciated cost of the improvements, although he had never

Basis for gain or loss and basis for depreciation being for all practical purposes identical—with adjustments and exceptions not here pertinent, sections 113 and 114, Internal Revenue Code of 1939; *Johnson* v. *Commissioner*, *supra*—the reasoning of the *Bennet* case would mean that *Detroit Edison* must inferentially have decided that the contributions involved there had never been properly reportable as taxable income. In other words, if the *Bennet* result is right, the present conclusion must be wrong.

But since I think the theory of the *Bennet* case cannot be supported,[3] I agree with this result.

KERN, *J.*, dissenting: In this case we are not concerned with the effect of the contributions here involved on petitioner's basis for depreciation with regard to the property purchased with those contributions, but with the question of whether these contributions constitute income taxable to petitioner. In my opinion, they were contributions of capital made by the contributors in order to furnish the funds necessary for the construction of a television signal transmission system by a corporation just starting out in business and having itself insufficient capital with which

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reported any part of such cost or value in his income. We denied the deduction on the ground that an income item is not, for tax purposes, converted into a capital asset, having a cost basis, until it is first taken into income. * * *

In *Commissioner* v. *Farren*, 82 Fed. (2d) 141, the taxpayers in 1918 each received shares of stock in an oil company as compensation for services rendered. Although taxable as income for 1918, no return was made for that year, on the theory that no income was derived until the stock was sold. The stock was sold in 1926, and the taxpayers contended they were entitled to deduct the value of the stock when acquired, notwithstanding such value had not been returned as income. The deduction was disallowed.

In *Long* v. *Commissioner*, 96 Fed. (2d) 270, affirming 35 B.T.A. 479, the court held that the worthless obligation of a husband to pay alimony was not deductible as a bad debt, since there was no cost basis of the debt sought to be deducted.

In *Alamo National Bank of San Antonio, Executor*, 36 B.T.A. 402; aff'd., 95 Fed. (2d) 622, the petitioners were the sole stockholders of a corporation from which they received a Coca Cola franchise in 1921 as a liquidating dividend, but did not include in their income for that year any amount on account of the receipt of the franchise. They sold the franchise in 1931, and we held they were not entitled to deduct any value for the franchise as a basis for computing gain from its sale. [*Ruth B. Eaton*, *supra* at 1196, 1197.]

[3] See Footnote 2, *supra*.

to construct such a system. It is obvious that without these contributions, which furnished 87 per cent of the funds spent for the construction of the necessary facilities by petitioner during the period February February 20, 1951, to January 31, 1953, petitioner could not and would not have begun business. I am unable to see why these contributions, which in my opinion were contributions to petitioner's capital, must be taxed as income to petitioner merely because the ultimate motive of the contributors was their interest in obtaining services which could not have been available to them unless and until they had furnished by this means the capital which petitioner required in order to erect the facilities necessary for the furnishing of such services.

In my judgment, the situation presented by the instant case is distinguishable from that referred to by the dictum in the *Detroit Edison* case quoted in the majority opinion—a dictum appearing in an opinion which considered the question of basis for depreciation rather than the question of whether the contributions constituted income. In any event, it would seem to me to be better judicial technique for this Court to follow the clearly applicable and heretofore unreversed precedents furnished us by *Edwards v. Cuba Railroad Co.*, 268 U.S. 628; *Great Northern Railway Co.*, 8 B.T.A. 225, aff'd 40 F. 2d 572, certiorari denied, 282 U.S. 855, and the other cases noted in the majority opinion, rather than to assume from "a gradually but persistently broadening concept of taxable income * * * exemplified by the *Glenshaw Glass Co. and General American Investors Company* cases" that the Supreme Court, by its dictum in the *Detroit Edison* case, intended to overrule the long line of cases starting with *Edwards v. Cuba Railroad Co., supra.*

Upon the facts of the instant case, and applying the law as it is revealed to us by existing precedents, it is my judgment that the issue before us should be decided in favor of the petitioner, and I, therefore, note my dissent.

Decision

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed January 29, 1957, it is

ORDERED AND DECIDED: That there are deficiencies in income tax for the fiscal year ended January 31, 1952 in the amount of $3,210.83 and for the fiscal year ended January 31, 1953 in the amount of $13,013.09.

/s/ NORMAN O. TIETJENS
Judge

Entered: January 29, 1957.

APPENDIX B

Statutes and Regulations Involved

Statutes

Internal Revenue Code of 1939, as amended:

Sec. 21. Net income.

(a) Definition. "Net income" means the gross income computed under section 22, less the deductions allowed by section 23. (Act of February 10, 1939, 53 Stat. 9, as amended).

Sec. 22. Gross income.

(a) General definition. "Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or

sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

(Act of February 10, 1939, 53 Stat. 9, as amended).

Internal Revenue Code of 1954:

Sec. 61. Gross income defined.

(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

(Act of August 16, 1954, c. 736, 68A Stat. 17).

Sec. 118. Contributions to the capital of a corporation.

(a) General rule.—In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. (Act of August 16, 1954, C. 736, 68A Stat. 39).

Sec. 362. Basis to corporations.

• • •

(c) Special rule for certain contributions to capital.—

(1) Property other than money.—Notwithstanding subsection (a)(2), if property other than money—

(A) is acquired by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such, then the basis of such property shall be zero.

(2) Money.—Notwithstanding subsection (a)(2), if money—

(A) is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such, then the basis of any property acquired with such money during the 12-month period beginning on the day the contribution is received shall be reduced by the amount of such contribution. The excess (if any) of the amount of such contribution over the amount of the reduction under the preceding sentence shall be applied to the reduction (as of the last day of the period specified in the preceding sentence) of the basis of any other property held by the taxpayer.

Regulations

The particular properties to which the reductions required by this paragraph shall be allocated shall be determined under regulations prescribed by the Secretary or his delegate.

(Act of August 16, 1954, c. 736, 68A Stat. 118).

Regulations

Treasury Regulations 111 (Internal Revenue Code of 1939):

Sec. 29.21-1. Meaning of net income.—

* * *

(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. * * *

(b) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by chapter 1. (See section 22.)

(c) Net income, meaning gross income less statutory deductions.

* * *

Sec. 29.22(a)-1. What included in gross income.—

Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, and from both combined, provided it is understood to include

profit gained through a sale or conversion of capital assets. * * *

Income Tax Regulations (Internal Revenue Code of 1954):

Sec. 1.118-1. Contributions to the capital of a Corporation.

In the case of a corporation, section 118 provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. Thus, if a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. Section 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production. See section 362 for the basis of property acquired by a corporation through a contribution to its capital by its stockholders or by nonstockholders.